ANNUAL REPORT 1988-89

BRITISH COLUMBIA FERRY CORPORATION

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MINISTER'S MESSAGE

The Honourable
DAVID C. LAM
Lieutenant-Governor
of the Province of British Columbia

MAY IT PLEASE YOUR HONOUR

I respectfully submit herewith the Annual Report of the British Columbia Ferry Corporation for the fiscal year ended March 31, 1989 in compliance with the provisions of the Ferry Corporation Act.

Neil Vant
Minister of Transportation and Highways
Minister Responsible, British Columbia Ferry Corporation

Year ended March 31	1989	1988	1987	1986	1985
		(expressed in thousands)			
FINANCIAL					
Operating revenue - gross	187,599	168,488	163,954	134,900	125,530
Operating expense	181,830	176,083	182,616	146,245	125,308
Operating loss before subsidy	6,957	19,145	31,281	20,535	8,771
Subsidy	51,000	57,000	57,000	40,000	43,000
Cash flow from operations	39,623	27,231	20,309	18,032	28,355
Depreciation and amortization	28,898	29,663	29,552	29,013	31,064
Interest on debt	11,229	12,223	10,387	7,132	5,177
Working capital (deficiency)	7,265	12,202	(5,172)	(9,353)	2,536
Net additions to property	7,559	9,292	1,817	68,219	12,456
Total assets	370,121	365,230	372,523	349,416	309,622
Long-term debt	26,158	31,858	37,558	43,258	43,258
Obligations under capital leases	86,878	87,791	88,591	47,861	—

Certain of the above figures for 1988 and prior years have been modified to make them comparable with the 1989 figures.

OPERATIONS*			(expressed in thousands)		
Traffic					
Passengers	17,919	17,014	18,235	13,497	11,913
Vehicles	6,885	6,491	6,526	5,049	4,460
Miles					
Passengers	336,399	317,424	375,893	286,568	269,703
Vehicles	121,714	114,816	123,970	101,426	96,531
Utilization %					
Passengers	27	27	34	30	28
Vehicles	65	63	60	60	59

* Operations data for Traffic and Miles includes data from the Northern Gulf Island routes acquired from the Ministry of Transportation and Highways in October, 1985 from the date of acquisition. The utilization and calculation for the Northern Gulf Island routes, however, was consolidated on April 1, 1987 for the 1987/88 fiscal year and is not included in the calculation for prior years.

B.C. Ferries is a provincially-owned and-operated Crown Corporation that provides passenger and vehicle service to 42 ports of call along the coast of British Columbia.

Our 38 vessels operate on 24 routes to carry residents, visitors, business travellers, bus and commercial vehicle operators. B.C. Ferries is their vital sealink between the British Columbia mainland and the many islands dotted along the coast of Canada's most westerly province.

Since 1960, when the provincial ferry fleet began operation with two ships, there has been constant growth; in traffic and in the number and size of the vessels needed to handle that traffic.

Between 1962 and 1965, ten new ships were built in Victoria. Two more ships were purchased in 1969.

In 1968, seven of the major vessels were modified to improve their carrying capacity. Ramps were installed on the car decks leading to mezzanine decks fastened to the midships bulkhead. With this innovation, the ships could carry 150 vehicles - a 40 vehicle increase.

A significant innovation was implemented in 1969. Each major vessel was taken to the shipyard and cut in half. An 84 foot section was built, floated into place and the ship was reassembled. Now, the ships could carry 192 vehicles. At the same time, the dining rooms were extended and the solarium seating was added, in the new section, on the sun deck aft of the bridge.

The jumbo vessels, Queen of Cowichan and Queen of Coquitlam, were built locally in 1976 and added to the fleet. Each could carry 362 cars. The Queen of Alberni, the next ship to join the fleet, was built specifically to carry overheight, commercial and recreational vehicles.

Three minor vessels, Mayne Queen, Powell River Queen and Bowen Queen, were stretched and repowered to carry 70 vehicles. As well, it became evident that additional "C" class ferries, like the ones built in 1976, were needed and construction began on Queen of Surrey and Queen of Oak Bay.

In the spring of 1981, another enormous and exciting conversion program began. Two of the original seven major vessels, built between 1962 and 1964, that had already been "stretched", were now "lifted".

The ships were cut in half again, horizontally this time. The top half was raised on hydraulic jacks and a new vehicle deck inserted. With these changes, the ships could carry over 280 cars.

The upper sun deck solariums also underwent change. They were enclosed and made into attractive lounge seating areas. The mid-ship lounge on the promenade deck was also renovated and a snack bar was added.

Three years later, Queen of Alberni - B.C. Ferries "overheight vehicle" ferry was lifted to add a new car deck. This increased her car-carrying capacity from 150 to 310 vehicles.

In October 1985, the 14 saltwater ferries (formerly operated by the Provincial Ministry of Transportation and Highways) were transferred to B.C. Ferries. This made the Crown Corporation one of the largest ferry operations in the world, in terms of the number of ships (38) and routes (24).

B.C. Ferries' traffic has continued to grow every year and in 1989, B.C. Ferries will embark on an exciting Capital Expansion Program that involves the construction of two super ferries and two minor ferries. In addition, improvements to the four major terminals are planned.

The challenge continues - to provide our passengers with an excellent transportation service. And be B.C.'s FriendShip Fleet.

R. WILLIAM LONG

Chairman of the Board, was appointed in January, 1987. He brings to the Corporation many years of experience in municipal and provincial administration.

ROBERT H. WRIGHT

Vice Chairman, has been a Director since 1981. A resident of Oak Bay, he is President of Oak Bay Marine Group. He is Chairman of the Executive Committee and a member of the Planning Committee.

BARBARA J. DUGGAN

was appointed in March, 1988. She is currently Director of Corporate Communications for the Vancouver Port Corporation. She is a member of the Board's Audit and Executive Committees.

ARTHUR P. LLOYD

was appointed to the Board in September, 1987. He is a resident of Salt Spring Island, having retired after a career in the lumber industry. He is Chairman of the Audit Committee and a member of the Planning Committee.

HAROLD J. LONG

was appointed a Director in November, 1986. He is a long-time resident of Powell River and is currently the sitting member for the constituency of Mackenzie.

JOSEPH MORRIS

was appointed a Director in May, 1984. A past President of the Canadian Labour Congress, he is now retired and lives in Saanich. He is Chairman of the Finance Committee and a member of the Executive Committee.

ALLAN OKABE

was appointed in March, 1988. He brings to the Board his experience as the operator of a small shipyard on the Province's north coast. He is a member of the Audit and Finance Committees.

CLIFFORD M. (MACK) STONE

was appointed in March, 1988. He is a resident of Parksville on Vancouver Island. While a mechanical engineer by profession, he now has a variety of small business interests. He is a member of the Board's Planning and Finance Committees.

MICHAEL D.W. YOUNG

is a practising lawyer, resident in Victoria, and is a former mayor of Victoria. A Director since 1981, he is Chairman of the Planning Committee and a member of the Executive Committee.

To the Honourable Neil Vant
Minister of Transportation and Highways
and Minister Responsible for British Columbia Ferry Corporation

The 1988-89 fiscal year has presented the Corporation with an opportunity to look at its business position and set about structuring itself to meet the Province's needs for the coming years. In an economic climate of strong growth, giving rise to solid traffic increases, B.C. Ferries must address both its operational responsibility and its fiscal responsibility by providing adequate future capacity at a cost which the Province can bear.

Fleetwide statistics show passenger travel up 5.3% and vehicle travel up 6.1%. To continue to adequately meet the growing transportation needs of its users, the Corporation must provide greater capacity on several of its routes in the near and medium term. The most urgent requirement is on the Strait of Georgia (Vancouver Island - Mainland) routes, where the volume of growth is highest.

The Corporation is in the process of designing new vessels suitable for the Tsawwassen - Swartz Bay service. Alternatives to these plans have been considered by your Board of Directors, but the Corporation is confident that any longer-term alternative would complement, rather than conflict with, the vessel construction program. The fleet is aging and cannot be expected to efficiently serve the Province indefinitely. The four largest vessels operating on Tsawwassen - Swartz Bay were built in 1962-63, and the eventual retirement of all four must be a component of the Corporation's plans.

As part of its consideration of growing demand, the Corporation reviewed the possibility of implementing a "Third Crossing" between Vancouver Island and the Lower Mainland. Such a project, because of the lengthy planning sequence involved, does not alleviate the current urgent requirement for newer major vessels.

The ferry system also requires additional minor vessels, so that a suitable match of vessel size and schedule can enable the Corporation to provide its users with a satisfactory level of frequency and capacity at an affordable cost. Research and design is currently underway for such vessels, for disposition to those areas where traffic pressure is greatest. The annual fluctuation in traffic (from winter to summer) combined with the need to undertake annual maintenance, means that these vessels must be suitable for a variety of routes.

This construction program, which will last at least five years, will be parallelled by developments at several of the Corporation's terminals, to accommodate additional traffic. This will primarily affect the major terminals of the Strait of Georgia service.

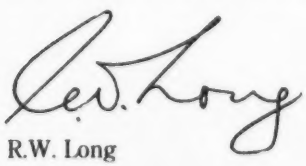
During the year, the Government received a report on Province-wide transportation policy, which may have major implications for the marine transportation services provided by B.C. Ferries. The Corporation is adjusting its planning processes to align with the Government's inter-agency transportation planning committee.

The Government's privatization initiative has caused the Corporation to assess the various business functions it performs within its mandate, with the result that there has been a far greater awareness this year of the distinction between core corporate functions and peripheral functions.

During 1988-89 the Corporation successfully concluded a two-year Collective Agreement with the British Columbia Ferry and Marine Workers' Union. This agreement was obtained without recourse to job action, continuing a stable labour relations history which now stretches back ten years.

In looking forward, to the 1989-90 fiscal year and into the 1990's, the Corporation is hopeful that it can continue to serve the Province at a level which meets the economic and social requirements of her people at a cost, to the Province and to the individual user, which is affordable for both.

On behalf of the Board of Directors,



R.W. Long

It was a year of growth, assessment, planning and decision-making.

Throughout the year, passenger and vehicle traffic statistics continued their upward trend. During 1988-89, system-wide traffic reached 17.9 million passengers (up 5.3%) and 6.9 million vehicles (up 6.1%).

This growth put tremendous demands on our ships' vehicle lift-off capabilities, especially during peak periods. The refit period also placed great strain on our ability to match adequate ship service to a particular route.

These facts underscored our own forecasting. We had reached a point where we had maximized capacity on the vessels we had and it was clear that continued traffic growth could mean just one thing. We would have to expand the fleet if we were to continue to meet our service commitments. With that knowledge in mind, we pursued a concentrated course of information-gathering, consulting, planning, assessing and decision-making, which culminated in the Ministerial announcement, in the March Budget Speech, of our Capital Expansion Program.

The information-gathering, at one point, took a B.C. Ferries technical group to visit the European Cross Channel Ferry Services, to study all aspects of these ships and their loading facilities.

Each of the steps leading up to putting a program "on paper" were careful ones. They were made, one at a time, after a thorough evaluation of all the factors involved.

In terms of growth, weighing each factor is vital. The needs of our serviced communities must be carefully balanced against the capacity we can responsibly and sensibly offer. These are changing transportation times. There is a growing leisure and tourism market, for instance, that must be considered in any evaluations we make. Here, too, a delicate balance must be maintained.

The Capital Expansion Program, as it stands, maintains this sense of balance, and also provides the possibility of alternative transportation solutions in the years to come, that will complement the proposed Program.

As we look back on our activities this year, we see this pattern of maximization of assets and planning for the future illustrated in every major area of the Corporation.

OPERATIONS

This past year, we met the everyday challenges that come with carrying 17,919,144 passengers and 6,884,784 vehicles - safely and efficiently. Operations manages the terminals and ships of the system to provide effective, dependable and safe coastal ferry transportation services in the most efficient manner possible.

Parking continues to present problems from time to time at all of the four major terminals. At Swartz Bay a realignment of the area and relocation of the pay-parking booth has resulted in over 100 additional spaces for the public. The installation of vehicle height/length measuring devices at two major terminals has proven successful in aiding the fair application of the tariff; units are now being installed at all major terminals.

In December, the final phase of Campbell River Terminal was opened for use. The new waiting room, ticket booth and administration building will improve service to the public.

The second traffic lane to the north road bypass in Langdale, which was completed by the Ministry of Transportation and Highways in late March, was a tremendous help to vehicles coming and going from the terminal. Regrettably, Berth #2 at Langdale suffered major damage in February 1989 as a result of a collision by the Queen of Cowichan.

We have made major strides in the area of risk management. We have taken measures which will do the most to reduce the likelihood and severity of marine risks, while minimising the impact upon operating functions. This work by Operational Standards has been aided by the underwriters, resulting in a broad-based program aimed at both safety and service. Tragic events throughout 1988-89 in other jurisdictions, such as Brazil, the Philippines and the Mediterranean have reminded us of the need for constant vigilance, and improvement, in the face of growing expectations.

CATERING AND PASSENGER SERVICES

We had an excellent year in our Catering and Passenger Services Department. Overall sales increased by 15% to $32.5 million.

During the year, the fleet-wide training was mainly dedicated to food quality and food cost control. The training has paid off. Quality has continued to improve and food costs have declined.

We maintained revenue growth by continuing programs such as the summer Newsstand on secondary routes, trade-ups for selected menu items and an ongoing emphasis on buffets.

Both the Newsstand and the Test Kitchen have matured during the past year. In the Test Kitchen we spent more time addressing the ever-increasing pressures of food-based consumerism. In the Newstand we concentrated on improved control and merchandising techniques.

General shipboard passenger services are constantly being upgraded. During the past year, a children's play area was successfully tested on the Queen of Vancouver. Play areas are scheduled for installation on all major vessels for the summer of 1989. Cellular credit card phones are also planned for the summer of 1989 on the service between Swartz Bay and Tsawwassen.

FLEET ENGINEERING

We completed our Fleet Asbestos Removal Program during the year, with competitive bids being called for the Queen of Prince Rupert, Queen of Alberni, Queen of Coquitlam, Queen of Cowichan, Queen of Vancouver, Queen of Victoria, Tachek, Nicola and Kwuna. This $22 million asbestos removal program, carried out over a three year period, seems well accepted by our employees and there is a sense of great accomplishment in the realization that the project is complete.

Our Fleet Engineering operation continued at a busy level during the year with 38 vessels being operated, refitted, drydocked and maintained. The refits and drydockings were carried out both at local shipyards and at our Deas Dock Refit Complex.

The Tachek was fitted with specially designed sponsons to permit her to carry heavier commercial loads, in addition to her usual mix of vehicles. The Howe Sound Queen was fitted with similar sponsons to increase her lift-off capacity. In both cases, these additions were very successful, and provided greater lift capacity with no loss in service speed.

During the year, we also replaced the 25 year old main generators in the Queen of Saanich, Queen of Esquimalt, Queen of Vancouver and Queen of Victoria with new main generators. In addition, the Queen of Tsawwassen was fitted with an elevator for the benefit of our disabled passengers.

The Mill Bay, Salt Spring Queen and Vesuvius Queen all needed extra work this year to keep these older vessels at the required operating service levels.

We also made platform modifications to the Queen of Saanich and Queen of Vancouver to improve their flexibility and total vehicle lift-off capability. Now both vessels can operate, when necessary, with double-laned platforms on both sides of the main deck. Plans are being drawn for the Queen of Esquimalt and Queen of Victoria to be similarly outfitted.

TERMINAL ENGINEERING

We had another very busy year in Terminal Engineering as we planned, constructed and maintained our terminals.

Our primary planning exercise was the development of concept plans for the various terminals as part of the corporate ten-year plan. The proposals include upgrading of existing facilities and the creation of new terminals.

In December, we finished the final phase of the Campbell River Terminal reconstruction project. The complex included a new waiting room, ticket booth and administration building.

An exhaustive parking study was conducted to tell us what we needed in the way of pay parking at the major terminals and to give us possible courses of action. The urgency of requirements at Swartz Bay resulted in a short-term solution.

During the year we used conventional methods, plus newer technology, such as underwater video cameras to continue the inspection of our facilities.

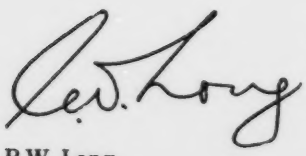
We used contractors and in-house staff to do follow-up work for repair or replacement. Loading ramps at Swartz Bay, Nanaimo, Earls Cove and Quathiaski Cove were replaced or given major repairs. We repaired or replaced many dolphins during the year.

General Manager's Report continued on page 25

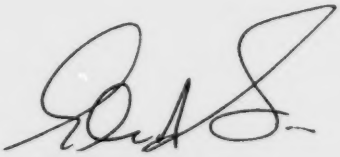
The financial statements of the British Columbia Ferry Corporation have been prepared by management in accordance with accounting principles generally accepted in Canada which have been consistently applied and are appropriate in the circumstances. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations which have been made using careful judgement. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized in the notes to the financial statements. Financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

Management depends upon a system of internal controls in order to provide reasonable assurance, on a cost-effective basis, that financial information is reliable and accurate. The system of internal controls is monitored by internal auditors. Our external auditors also independently perform such tests of the system of internal controls as they consider necessary for the purpose of expressing their opinion on the financial statements. The Audit Committee, which is comprised of directors who are not employees, meets regularly with representatives of the external auditors, the internal auditors and management in order to satisfy themselves that the B.C. Ferries' system of internal controls is functioning correctly.

Management is responsible for all of the information in this Annual Report, which has been reviewed by the Audit Committee and approved by the Board of Directors.



R.W. Long
Chairman and Chief Executive Officer
May 29, 1989



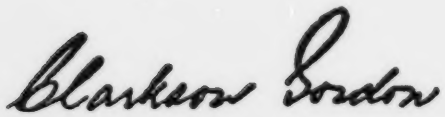
G.A. Brown
Assistant General Manager, Finance

Clarkson Gordon
Chartered Accountants

To the Lieutenant-Governor in Council
Province of British Columbia:

We have examined the balance sheet of British Columbia Ferry Corporation as at March 31, 1989 and the statements of income and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Corporation as at March 31, 1989 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.



Chartered Accountants

Victoria, Canada
May 19, 1989

BALANCE SHEET

As at March 31, 1989

ASSETS *(expressed in thousands)*		1989	1988
Current Assets			
Cash		$ 14,868	$ 22,129
Accounts receivable		2,845	2,826
Inventories	(Note 2)	10,768	11,022
Prepayments and deposits		4,757	2,668
Current portion of reserved funds	(Note 3)	5,700	5,700
Current portion of debenture	(Note 4)	905	835
		39,843	45,180
Reserved Funds	(Note 3)	45,911	12,297
Debenture	(Note 4)	39,226	40,130
Fixed Assets	(Note 5)		
Ships, berths, buildings, equipment and land		565,104	557,641
Less accumulated depreciation		322,179	293,377
		242,925	264,264
Deferred Charges	(Note 6)	2,216	3,359
		$ 370,121	**$ 365,230**

Approved by the Board

Director

Director

LIABILITIES *(expressed in thousands)*		1989	1988
Current Liabilities			
Accounts payable and accrued liabilities		$ 23,123	$ 23,966
Deferred revenue		2,407	2,032
Current portion of long-term debt	(Note 7)	5,700	5,700
Current portion of obligations under capital leases	(Note 8)	1,348	1,280
		32,578	32,978
Long Term Debt	(Note 7)	26,158	31,858
Obligations under Capital Leases	(Note 8)	86,878	87,791
Accrued Sick Leave Liability	(Note 9)	5,735	5,705
		151,349	158,332
SHAREHOLDER'S EQUITY			
Share Capital			
Authorized			
1,000,000 shares without par value with a maximum consideration of $100,000,000			
Issued			
68,512 shares		6,851	6,851
Contributed Surplus	(Note 10)	250,401	250,401
Deficit		(38,480)	(50,354)
		218,772	206,898
		$ 370,121	$ 365,230

INCOME AND DEFICIT

		(expressed in thousands)	
Year ended March 31		1989	1988
Operating revenues			
Tolls		$ 153,114	$ 138,591
Catering and other income		34,485	29,897
Operating Subsidy	(Note 11)	51,000	57,000
		238,599	225,488
Operating expenses			
Salaries, wages and benefits		116,919	111,080
Depreciation		28,898	29,663
Fuel and lubricants		23,707	25,418
Operating supplies and services		20,807	18,557
Repairs, maintenance and replacements		14,889	16,233
Cost of food and goods sold		12,726	11,550
General and administration		5,508	4,795
		223,454	217,296
Income from operations		15,145	8,192
Investment income		7,958	5,593
Interest on long term obligations		(11,229)	(12,223)
Net interest expense		(3,271)	(6,630)
Income for the year		11,874	1,562
Deficit at beginning of year		(50,354)	(51,916)
Deficit at end of year		$ (38,480)	$ (50,354)

		(expressed in thousands)	
Year ended March 31		1989	1988
Operational Activities			
Cash generated from (used by) Operations	(Note 12)	$ 39,623	$ 27,231
Financial Activities			
Payments from reserved funds		5,700	5,700
Long term debt payment		(5,700)	(5,700)
Payments received on debenture		834	771
Capital lease		—	102
Capital lease payments		(845)	(750)
Payments to reserved funds		(37,480)	(5,327)
Appreciation of reserved funds		(1,834)	(1,580)
		(39,325)	(6,784)
Investment Activities			
Fixed asset additions		(7,559)	(9,292)
Increase (Decrease) in cash		(7,261)	11,155
Cash at beginning of year		22,129	10,974
Cash at end of year		$ 14,868	$ 22,129

In this statement cash includes only cash available for day to day operations and does not include Reserved Funds cash.

1. *Significant Accounting Policies*

The Corporation was incorporated under the Ferry Corporation Act on June 30, 1976 and commenced operations on January 1, 1977. The shares of the Corporation are held by the Minister of Finance as representative of Her Majesty the Queen in right of the Province of British Columbia.

In accordance with Section 8(7) of the Ferry Corporation Act the financial statements of the Corporation are prepared in accordance with generally accepted accounting principles. Significant accounting policies adopted in the preparation of these financial statements are as follows:

Inventories -

Inventories are valued at the lower of cost and current replacement cost.

Long-Term Disability Plan -

The Corporation records as a current year expense the change in reserves for the estimated present value of payments, until retirement, to employees currently receiving benefits from the Long-Term Disability Plan. The plan is administered by the Superannuation Branch of the Public Service Commission, which receives and invests premiums from the Corporation. The excess of premiums paid under the Plan over reserves required for future payments is included in prepayments and deposits.

Fixed assets -

Acquired from the Province of British Columbia:

(a) Ships

Ships, which comprise part of the total assets acquired from the Province effective January 1, 1977 by Order-In-Council No. 3610 dated December 16, 1976 and which were transferred to the Corporation at an assigned value of $1, have been revalued by the Corporation and are reflected in the accompanying financial statements at their estimated depreciated replacement value as at January 1, 1977.

Three ships presently under charter by the Province until 1994 are subchartered to the Corporation for the same period at an annual cost of $1 each. Under the terms of the subcharter agreement with the Province, the Corporation may in 1994 request that the Province exercise its option to purchase these ships at its own expense in which case clear title to the ships will be transferred to the Corporation. Accordingly, these ships are included in the capital assets of the Corporation and are reflected in the accompanying financial statements at their estimated depreciated replacement value as at January 1, 1977.

(b) Berths, buildings and equipment

Berths, buildings and equipment which comprise the balance of the total assets transferred at an assigned value of $1, are reflected in the accompanying financial statements at their estimated depreciated replacement value as at January 1, 1977.

On October 1, 1983 the buildings and equipment at the Deas Dock facility, not acquired from the Province on January 1, 1977 were transferred at an assigned value of $1. These assets are included in the capital assets of the Corporation and are reflected in the accompanying financial statements at their estimated depreciated replacement value as at October 1, 1983.

Other additions and disposals subsequent to January 1, 1977:

The costs of major replacements, additions, extensions and improvements are capitalized in the fixed asset accounts. On retirement or disposal of fixed assets, the costs thereof and the related accumulated depreciation are eliminated from the accounts and any gains or losses are reflected in the statement of income.

The costs of maintenance, repairs, and minor renewals or replacements are charged against income.

Depreciation -

Fixed assets are depreciated on the straight line method based upon the following useful lives:

Ships	25 years	Berths	5 - 10 years	Buildings and equipment	4 - 25 years

Leases -

All leases which transfer substantially all of the benefits and risks incidental to the ownership of property are accounted for as if they were an acquisition of assets and incurrence of obligations at the inception of the lease. Assets recorded under capital leases are depreciated on a straight-line basis over the appropriate useful lives.

All other leases are accounted for as operating leases wherein rental payments are expensed as incurred.

Amortization of long-term debt discount and issue costs -

Promissory note discount is amortized on a compound interest method over the term of the debt. Issue costs for promissory notes and capital leases are amortized on a straight-line basis over the term of the debt.

Provision for annual refit costs -

The Corporation provides for ship refit expense by charging income with the anticipated refit costs over the period between refits. Any differences between the provision and the actual refit costs are recognized in the year the refit takes place.

Comparative figures -

Certain comparative figures have been reclassified to conform with the presentation adopted for the current year.

2. Inventories

Year Ended March 31	1989	1988
	(expressed in thousands)	
Spare components, parts and supplies	$ 9,023	$ 9,278
Fuel and lubricants	1,005	1,083
Catering supplies and goods for resale	740	661
	$ 10,768	$ 11,022

3. Reserved Funds

Funds designated to repay long-term debt and for other specific purposes are segregated by the Corporation and are administered by the Corporation or the Province.

Year Ended March 31		1989	1988
		(expressed in thousands)	
Funds designated for long-term debt	(Note 7)		
Administered by the Corporation		$ 8,019	$ 9,497
Less amount included in current assets to satisfy a current debt repayment		5,700	5,700
		2,319	3,797
Administered by the Province		2,087	1,582
		4,406	5,379
Funds designated for capital expenditures	(Note 14)		
Administered by the Corporation		33,212	—
Funds designated for a capital lease	(Notes 4 & 8)		
Administered by the Province		2,558	1,213
Funds designated to meet accrued sick leave liabilities	(Note 10)		
Administered by the Corporation		5,735	5,705
		$ 45,911	$ 12,297

The funds designated for capital expenditures are equal to the subsidy receivec from the provincial government less amounts required to cover operating losses, before depreciation, and capital expenditures.

4. Debenture

Year Ended March 31	1989	1988
	(expressed in thousands)	
8.18% Debenture issued by the Province of British Columbia due December 10, 2006	$ 40,131	$ 40,965
Less: Principal due within one year	905	835
	$ 39,226	$ 40,130

By agreement with the Province, semi-annual payments to the Corporation equal the amount required under the lease obligation for the Queen of Oak Bay (Note 8). Excess funds are placed in a sinking fund to cover future increased payments on the lease (Note 3).

5. Fixed Assets

	March 31, 1989			March 31, 1988
	(expressed in thousands)			
	Cost or Appraised Value	Accumulated Depreciation	Net Book Value	Net Book Value
Ships owned	$ 266,485	$ 156,687	$ 109,798	$ 119,299
Ships under capital lease	127,827	51,147	76,680	82,041
Berths, buildings and equipment	161,819	114,345	47,474	50,956
Land	5,695	—	5,695	5,695
Construction in progress	3,278	—	3,278	6,273
	$ 565,104	$ 322,179	$ 242,925	$ 264,264

6. Deferred Charges

Year Ended March 31	1989	1988
	(expressed in thousands)	
Long-term debt discount and expenses	$ 1,897	$ 3,021
Lease executory costs	319	338
	$ 2,216	$ 3,359

7. Long-term Debt

Year Ended March 31	1989	1988
	(expressed in thousands)	
8.95% Promissory notes (effective rate of 15.75%), are repayable in equal annual instalments of $5.7 million	$ 17,100	$ 22,800
Less current portion	5,700	5,700
	11,400	17,100
12.08% Promissory note (effective rate of 12.44%) due September 9, 2003 is repayable by annual sinking fund payments of $322,492	14,758	14,758
	$ 26,158	$ 31,858

Payable in fiscal year ending in:

1989	$ —	$ 6,022
1990	6,022	6,022
1991	6,022	6,022
1992	6,022	6,022
1993	322	322
1994	322	322
1995 and subsequent	7,448	7,126
	$ 26,158	$ 31,858

The Province of British Columbia unconditionally guarantees the payment of principal and interest on the promissory notes.

8. *Obligation Under Capital Leases*

The corporation has obligations under capital leases for the M.V. "Queen of Oak Bay", M.V. "Queen of Surrey", M.V. "Quinsam" and other equipment.

Year Ended March 31		1989	1988
		(expressed in thousands)	
Total minimum lease payments are:			
M.V. "Queen of Oak Bay	Implicit interest rate 8.14%	$ 92,510	$ 95,524
M.V. "Queen of Surrey"	Implicit interest rate 8.685%	81,919	86,406
M.V. "Quinsam"	Implicit interest rate 10.64%	7,227	8,089
Other equipment - Tractor	Implicit interest rate 10.0%	—	49
Other Equipment - Forklift	Implicit interest rate 10.4%	120	138
		$ 181,776	$ 190,206
Payable in fiscal year ending in:			
1989		$ —	$ 8,430
1990		8,380	8,380
1991		8,380	8,380
1992		9,218	9,218
1993		9,218	9,218
1994		9,218	9,218
1995 and subsequent		137,362	137,362
		181,776	190,206
Less interest		93,550	101,135
Present value of net minimum capital lease payments		88,226	89,071
Less current portion		1,348	1,280
		$ 86,878	$ 87,791

9. *Accrued Sick Leave Liability*

In 1978 the Corporation introduced short-term illness and injury and long-term disability plans and as of that date all employees ceased accruing sick leave credits. In the event of illness the accumulated sick time may be withdrawn prior to retirement. On retirement, any balance remaining is payable in cash at 50% of accredited time.

An actuarial evaluation by The Alexander Consulting Group Limited as at March 31, 1988 determined that the recorded liability for the portion payable on retirement was $395,000 in excess of that required. This excess is being reflected in operations over three years ending March 31, 1990.

Funds have been designated to meet the accrued sick leave liability (Note 3).

10. *Contributed Surplus*

Excess of estimated depreciated replacement value over assigned value of $1 of assets acquired from the Province of British Columbia.

Year Ended March 31	1989	1988
	(expressed in thousands)	
Ships, berths, buildings and equipment acquired January 1, 1977	$ 249,674	$ 249,674
Buildings and equipment acquired October 1, 1983	727	727
	$ 250,401	$ 250,401

11. Related Party Transactions

The Corporation received a cash subsidy of $51 million (1988 - $57 million) from the Province of British Columbia. This cash subsidy is determined annually

In addition, the Province pays $4.8 million for annual leases of three ships which are leased from the Province at an annual cost of $1 each.

The Corporation utilizes Crown land for terminals and highway access without the payment of rental or property taxes. The value of these benefits has not been determined. Section 21 of the Ferry Corporation Act states: "The Corporation, as an agent of the Crown, is not liable to taxation, including taxation on improvements, except insofar as the Crown is liable."

The Corporation engages in transactions with other government agencies, departments and Crown Corporations, notably B.C. Hydro and Power Authority and B.C. Systems Corporation, on the same terms as private sector customers.

12. Cash Generated from Operations

Year Ended March 31	1989	1988
	(expressed in thousands)	
Income for the year	$ 11,874	$ 1,562
Items not involving cash		
Depreciation	28,898	29,663
Amortization of promissory note discount and debt issue costs	1,143	1,334
Increase in accrued sick leave liability	30	977
Cash generated from (used for) operating working capital		
Accounts receivable	(19)	(1,158)
Inventories	254	(457)
Prepayments and deposits	(2,089)	(1,207)
Accounts payable and accrued liabilities	(843)	(2,935)
Deferred revenue	375	(548)
Cash generated from operations	$ 39,623	$ 27,231

13. Pension Plan

The Pension (Public Service) Act applies to the Corporation and its officers and employees. Accordingly, the Corporation is required to pay into the Public Service Superannuation Fund amounts prescribed from time to time by Regulation.

14. Commitments

In the budget speech on March 30, 1989, the Minister of Finance and Corporate Relations for the Province of British Columbia announced a 10-year, $550 million capital maintenance and expansion program for the Corporation. At March 31, 1989, no significant contracts had been entered into under this program.

It is the Corporation's intention to separate the annual subsidy received from the Province of British Columbia into its operating and capital components to reflect the government's stated intention that capital maintenance and expansion be financed from the subsidy.

General Manager's Report continued from page 12

To take care of day-to-day maintenance and minor replacement work, we based our maintenance crews at five strategic locations throughout the fleet: at Deas Dock in the Lower Mainland, Swartz Bay, Nanaimo, Courtenay and Powell River. These crews ensure that all shore facilities are properly maintained, and kept in safe operational condition - ready for use when they're needed.

FINANCE

On April 1, 1988, we began using new financial software to collect data and to provide reports to the Board, senior management, and operating managers in the fleet. These new reports will help the staff to be aware of the costs of their operations so that they can control them effectively. With this new financial software, we have improved the information we can give to our operating managers.

Using the new computer software, we have also improved the annual budgeting process, as well as the long-term financial planning and modelling procedures that illustrate how we will finance the Capital Expansion Program.

Besides supporting the new financial reporting software, our computer group developed a strategic plan to enable us to priorize other computer initiatives over the immediate and longer-term future. We signed an agreement with the B.C. Systems Corporation to supply our computer hardware, our computer software support and our network communications services. Our objective is to ensure that we have adequate computing power available when we need it.

This year, Materials Management introduced "just-in-time" supply and will be introducing regional access to local suppliers to reduce inventory levels. We also started the development of an inventory control program that will be operational by June, 1989. Our participation in "Market Discovery 88", which was sponsored by the Purchasing Commission, was intended to improve our local sources of supply, and possibly reduce costs.

Diesel fuel supply contracts are due for renewal in May 1989 and we are working closely with the Provincial Treasury and the Purchasing Commission to develop strategies which will protect the Corporation from the volatility of oil prices.

During the year, we expanded our Travel Card program to cover both the public

sector users and "essential service" users of the ferry system (School Boards, Ministries, B.C. Telephone Company, B.C. Hydro, etc.). This program improves the speed of processing in our ticket booths and contributes to an increase in our overall efficiency.

A tariff increase was approved to take effect on April 1, 1989. There had been no increase in regular passenger fares on any of our ferry routes since February, 1987.

HUMAN RESOURCES AND ADMINISTRATION

1988 was a collective bargaining year for the Human Resources Department. We signed a Collective Agreement for a two-year period; the 4th signed over the last 10 years without an incident. This contract provides for a general increase of $125/ month in the first year, and a 5% increase in the second year.

In order to meet the continued demand for human resources to increase our level of service, we added new positions in a number of areas; a notable one was our new Manager of Safety.

This past year, Corporate Training introduced the Workplace Hazardous Materials Information System in response to joint federal-provincial legislation. This required the preparation of approximately 600 material safety data sheets.

We also introduced a new Management Compensation Plan to ensure an internally equitable system for job evaluation and salary administration for our management employees.

There were many occasions, during the year, when we received word of how well our people performed their responsibilities with a sense of professionalism that demonstrated their commitment to service. This commitment to service is shown both on the ships and on shore and our people remain the backbone of the Corporation.

PLANNING

The Planning Department was actively involved in the development of the Corporate ten-year business plan during this past year. We expect traffic increases, especially on the major routes, to continue over the coming years. We will have to respond to the effects of these increases with the construction of new ships and the upgrading of our terminals.

During the year, the Planning Department was involved in detailed information collection. The process included long-term traffic forecasting, developing computer simulation models for traffic movement, conducting numerous traffic surveys and working in conjunction with the Finance Department to define our ten-year capital plan.

There were short-term planning projects too, such as reviewing the efficiency of contracted ferry services and determining tariff options.

Monthly traffic is closely monitored on all routes, along with tariff revenue, so we can regularly update forecasting models. These models have become a valuable tool in defining policy alternatives.

The Planning Department's micro-computers were upgraded this year, which has allowed a large database to be created. In turn, this data provided accurate information for us to use when discussing future ship and terminal design.

The Planning Department monitors Federal Ship Safety Regulations and ensures that we are well represented at regional and national meetings. This past year, there were many issues under discussion at these meetings, most significant being the updating of regulations with the emphasis on continual improvement of passenger and crew safety.

MARKETING AND PUBLIC RELATIONS

Our Marketing and Public Relations challenge - to successfully communicate to our employees, our passengers, the communities we serve, and the broader tourism market - was met head-on this year.

We developed a variety of Information cards for our employees to give to our passengers that will let them know clearly why we do some of the things we do. We also developed Service Information cards to hand out to passengers in the event of a service disruption or schedule change.

We worked closely with our service communities, throughout the year. This was especially significant during a year when we often did not have an ideal vessel to serve a specific community during refit period. The increased traffic demands affected our communities in many ways and the need for relevant communication was essential.

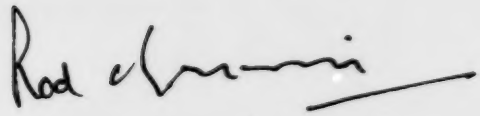
Over the years we have received requests from our passengers for a pre-paid ticket. This year we developed CirclePac, a prepaid ticketing concept that stipulated travel by two different B.C. Ferries routes - which would encourage passengers to see more of the province, as well as move our traffic from the predominately-used Tsawwassen/Swartz Bay route.

During 1988/89, we used radio as an affordable and effective way to educate and inform audiences in Victoria, Vancouver, Nanaimo and surrounding areas about our service policies and travel opportunities.

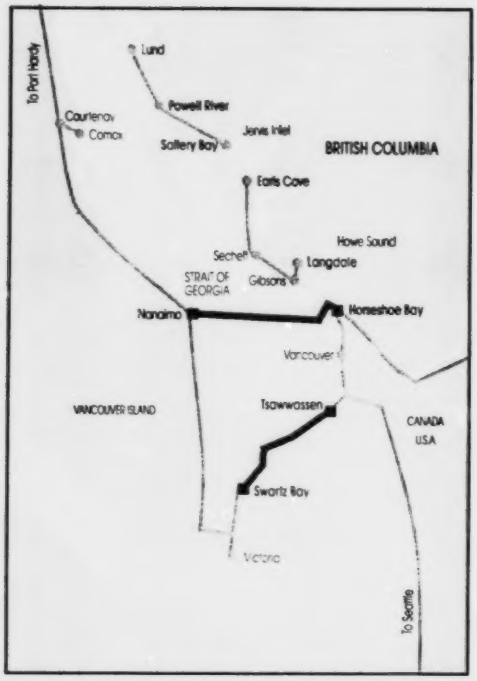
We increased our media relations efforts with a series of media releases that were distributed to select national and international publications. This resulted in such extensive coverage of our service that we were able to reduce our direct advertising efforts to an awareness-maintenance level.

So, throughout the year and throughout the fleet, we recognized, evaluated, planned, talked, listened and responded - to meet our current service needs. And prepare for the years ahead.

We do know, for certain, that these years ahead will be significant for B.C. Ferries, as we embark on the first new ship construction period in ten years. We end this year in a spirit of anticipation for what lies ahead.



Rod Morrison
General Manager



VANCOUVER ISLAND

During 1988-89, the Vancouver Island (Strait of Georgia) service carried increasing volumes of traffic - 6.1% more passengers and 6.3% more vehicles than in 1987-88. These 2 routes continue to account for approximately one-half of all vehicle and passenger trips in the B.C. Ferries system.

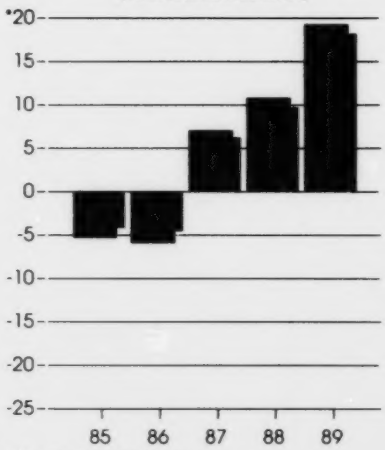
High utilization on these routes during the year has led to frequent overloads (traffic which has to wait for later sailings). Projections for traffic levels in future years indicate the need to provide additional capacity. Historical results indicate that Swartz Bay - Tsawwassen traffic will grow at a stable, if slow rate. In contrast, the traffic at Horseshoe Bay - Nanaimo is more volatile, prone to alternating patterns of high growth and low growth (even retrenchment on occasion). This has reinforced the Corporation's efforts to construct new, larger vessels for service between Swartz Bay and Tsawwassen.

Summer service between Swartz Bay and Tsawwassen is provided with V-class ships (286 - 376 car spaces, depending on configuration), augmented by 192-car stretch class vessels. All of these ships were constructed between 1962 and 1965. While they have been modified and improved over the intervening years, new construction will afford the opportunity to make design improvements to benefit both the travelling public and operational/navigational requirements.

Peak summer service between Horseshoe Bay and Nanaimo is provided with three "C" class ships (362-car capacity) and Queen of Alberni (310-car capacity, configured for a higher proportion of commercial and recreational vehicles).

A further result of high utilization on these routes is that revenue has increased faster than expenses. This has resulted in a $19.4 million surplus for the year.

Vancouver Island Service Area
Income/Loss after Depreciation
(Year Ended March 31)

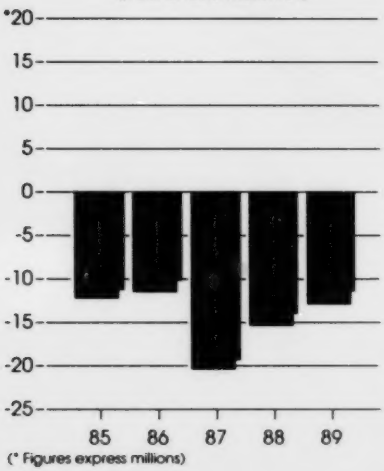


(* Figures express millions)

The information on this and the following four graphs has been restated to conform to the presentation adopted for the 1988-89 year.

SUNSHINE COAST

Sunshine Coast Service Area
Income/Loss after Depreciation
(Year Ended March 31)



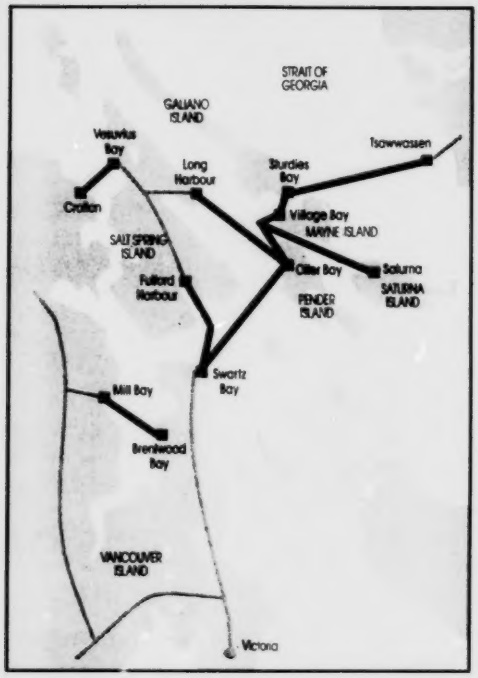
(* Figures express millions)

This area encompasses services in Howe Sound (from the Lower Mainland to Bowen Island and Langdale, and from Langdale to Gambier and Keats Islands), across Jervis Inlet (between Earls Cove and Saltery Bay) and in the Strait of Georgia (from Powell River to Comox and to Texada Island).

During the year, traffic in the area rose 4.5% (passengers) and 5.9% (vehicles). Commercial vehicle traffic increased significantly on the Horseshoe Bay - Langdale service. The number of commercial vehicles rose 12.4%, and not only has the number of units increased they are on average longer than in previous years. Total commercial footage has increased 18.7%. This reflects in part the pulp mill expansion underway at Port Mellon.

During February 1989, Langdale terminal suffered major damage at Berth 2 due to a hard landing. While no injuries or private-property damage resulted, the berth will have to be completely reconstructed. The damaged berth was the secondary dock, in use while the main two-level dock was undergoing regular maintenance.

While major improvements have been achieved in recent years, this area continues to generate a deficit, amounting to $12.9 million in 1988-89.



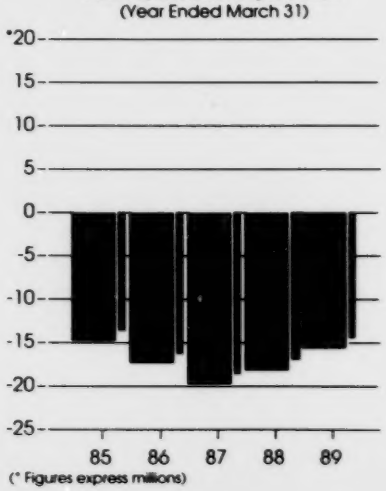
This area includes services to the islands of Galiano, Mayne, Pender, Salt Spring and Saturna from both Swartz Bay on Vancouver Island and Tsawwassen on the Lower Mainland. Additional services link north Salt Spring to Vancouver Island (Vesuvius Bay to Crofton), and link Brentwood Bay on the Saanich Peninsula to Mill Bay.

During the year, traffic grew faster in this area than in any other - by 7.2% in passenger traffic and 10.1% in vehicles. This reflects primarily the restoration of service between Crofton and Vesuvius Bay, following the destruction by fire of the Crofton dock in September, 1987.

These routes are used by residents, weekend cottagers and summer visitors to enjoy the rural beauty of the islands while maintaining access to the facilities offered by Vancouver and Victoria. It is the nature of multi-port services such as the Swartz Bay - Outer Gulf Islands and Tsawwassen - Outer Gulf Islands routes to be expensive to operate, while providing infrequent schedules and limited capacity.

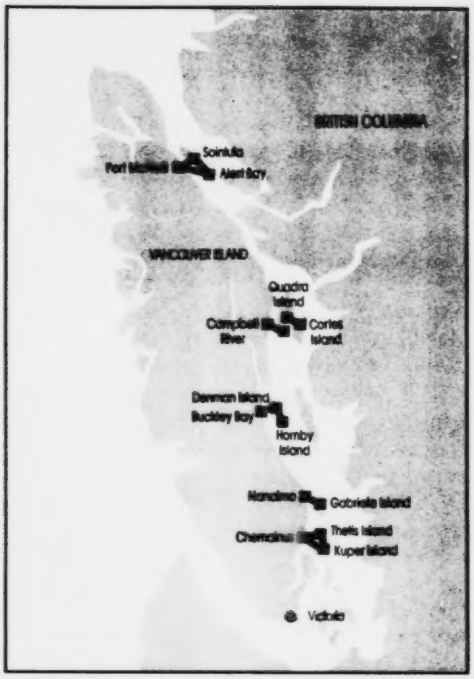
During 1988-89 this area generated a deficit of $15.7 million.

Gulf Islands Service Area
Income/Loss after Depreciation
(Year Ended March 31)

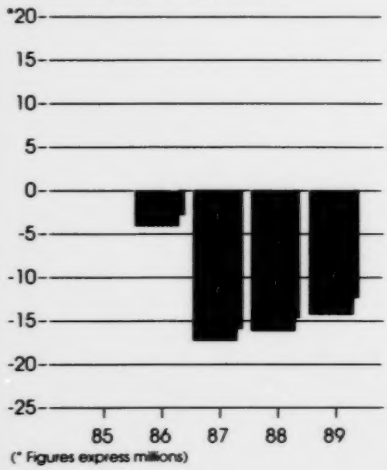


(* Figures express millions)

NORTHERN GULF ISLANDS



Northern Gulf Islands Service Area
Income/Loss after Depreciation
(Year Ended March 31)



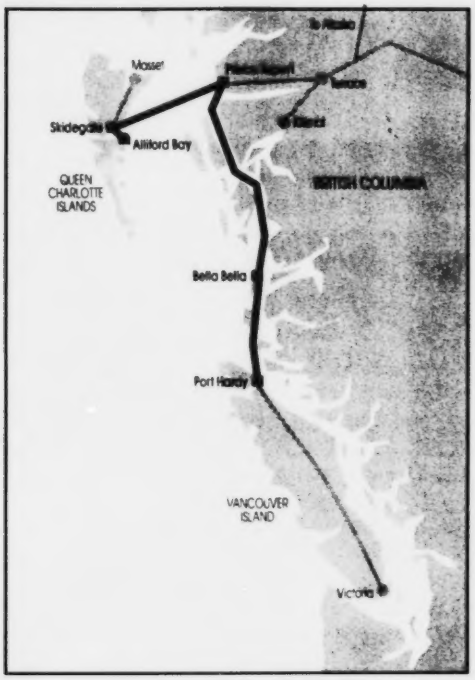
(* Figures express millions)

The seven routes of this area link the islands of Kuper, Thetis, Gabriola, Hornby, Denman, Cortes, Quadra, Cormorant and Malcolm to Vancouver Island. Service is provided by a variety of vessels in the 16-car to 70-car range, offering frequent service every day of the year.

These routes handled 2.77 million passengers (up 2.5%) and 1.13 million vehicles (up 3.3%) during the year, with the highest volumes of traffic being served at Quadra Island - Campbell River and at Gabriola Island - Nanaimo. These short and frequent commuter-type services have helped the islands to develop substantial populations.

During the year, the Corporation's service to some of these islands is impaired by the limited range of vessels available. Overload conditions were especially severe during the peak summer season at Hornby and Cortes Islands. At Quadra Island, conditions actually improved in July/August with the availability of a larger (70-car) vessel, compared to the spring and fall.

Over the course of the year this area incurred a deficit of $14.3 million, a significant improvement over 1987-88.



INSIDE PASSAGE

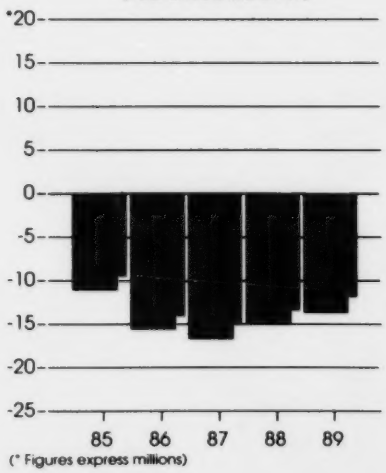
These routes link Prince Rupert, on the Province's mainland, to Port Hardy on northern Vancouver Island and to the Queen Charlotte Islands. In addition, a 26-car vessel connects the two main islands of the Queen Charlottes' group, operating between Skidegate and Alliford Bay.

During the year, the Kwuna was temporarily withdrawn from the Skidegate - Alliford Bay route to undergo her quadrennial drydocking and refit. A tug-and-barge and water-taxi were substituted to maintain service. The Kwuna is unique in the B.C. Ferries fleet in that the ship itself carries its loading ramps, rather than using shore-based adjustable dock structures.

The Inside Passage Day-Cruise continues to be popular with tourists, and passenger traffic increased 10.2% during the year, while vehicle traffic increased 4.5%. Service to the Queen Charlotte Islands also enjoyed above-average growth in passenger traffic (8.4%) although vehicle traffic was disappointing (up only 1.5%).

In spite of high utilization rates, this area continues to generate a deficit, this year amounting to $13.5 million.

Mid & North Coast Service Area
Income/Loss after Depreciation
(Year Ended March 31)



(* Figures express millions)

Vessels According to Vehicle Capacity	Year Built	Length (ft.)	Tons (Gross)	Capacity (Auto)	Capacity (Pass.)
Queen of Esquimalt	1963	427	9304	376	1394
Queen of Saanich	1963	427	9302	376	1394
Queen of Cowichan	1976	457	6551	362	1466
Queen of Coquitlam	1976	457	6551	362	1466
Queen of Oak Bay	1981	457	6969	362	1466
Queen of Surrey	1981	457	6969	362	1466
Queen of Alberni	1976	457	5863	310	1415
Queen of Vancouver	1962	427	9357	286	1360
Queen of Victoria	1962	427	9294	286	1360
Queen of Burnaby	1965	427	4903	192	987
Queen of Nanaimo	1964	427	4939	192	987
Queen of New Westminster	1964	427	4904	192	987
Queen of the North	1969	410	8807	157	750
Queen of Sidney	1960	336	3128	138	989
Queen of Tsawwassen	1960	336	3127	138	989
Queen of Prince Rupert	1966	332	5864	80	458
Powell River Queen	1965	279	1486	70	400
Howe Sound Queen	1964	241	805	70	400
Mayne Queen	1965	279	1476	70	394
Bowen Queen	1965	279	1476	70	394
Quinsam	1982	285	1458	70	400
Quinitsa	1977	245	1107	50	300
North Island Princess	1958	197	841	49	280
Queen of the Islands	1963	236	1717	45	483
Salt Spring Queen	1949	145	276	36	187
Vesuvius Queen	1950	150	277	32	177
Quadra Queen II	1969	163	771	30	200
Tachek	1969	163	751	30	150
Kahloke	1973	180	466	30	150
Klitsa	1972	156	348	26	150
Kwuna	1975	180	347	26	150
Tenaka	1964	155	651	18	206
Mill Bay	1956	120	175	16	168
Nicola	1960	110	255	16	134
Albert J. Savoie	1961	114	256	16	138
Nimpkish	1973	111	266	16	138
Garibaldi II	1964	110	337	7	332
Dogwood Princess II	1979	42	21	—	38

Year	Passengers	Vehicles
1961	692,000	221,000
1962	2,040,000	697,000
1963	2,665,000	895,000
1964	3,180,000	1,034,000
1965	3,300,000	1,185,000
1966	4,000,000	1,333,000
1967	4,477,000	1,516,000
1968	4,361,000	1,530,000
1969	4,774,000	1,733,000
1970	5,671,000	2,102,000
1971	5,963,511	2,228,412
1972	6,771,837	2,552,505
1973	7,629,385	2,824,964
1974	8,538,297	3,169,582
1975	9,612,501	3,558,234
1976	9,912,738	3,760,099
1977	8,383,502	3,044,167
1978	9,018,976	3,258,017
1979	10,399,203	3,758 628
1980	11,423,405	4,161,302
1981	12,512,898	4,625,917
1982	12,763,664	4,712,951
1983	12,275,466	4,462,731
1984	12,397,905	4,482,707
1985	11,912,943	4,460,069
1986	13,497,102	5,050,165
1987	18,235,197	6,525,684
1988	17,014,098	6,490,918
1989	17,919,144	6,884,784
Total	**251,341,772**	**92,257,836**